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EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

In the Matter of the Consolidated Arbitration of MCIMetro Access Transmission Services, Inc. and AT&T Communications of the Mountain States, Inc.	Docket No. U-3175-96-479 Docket No. U-2428-96-417

Exceptions of U S WEST Communications, Inc.

U S WEST Communications, Inc. submits the following Exceptions to the Arbitrators' August 15, 1997 Proposed Order addressing the issue of whether the U S WEST interconnection agreements with AT&T and MCImetro should require U S WEST to recombine unbundled network elements. For the reasons stated below, the Arizona Corporation Commission should not adopt the Arbitrators' Proposed Order because it conflicts with provisions of the Federal Telecommunications Act of 1996 and the Opinion of the United States Court of Appeals for the Eighth Circuit interpreting those provisions. *See Iowa Utilities Board v. FCC*, ___ F3d. ___, 1997 WL 403401 (8th Cir. 1997).

Summary of Exceptions.

The Eighth Circuit held directly that "the plain meaning of the Act indicates that [CLECs] will combine the unbundled elements themselves" and therefore CLECs "will in fact be receiving the elements on an unbundled basis." 1997 WL 403401 at *25 (emphasis added). Despite this plain language, the Arbitrators found that the interconnection agreements should require U S WEST to recombine unbundled network elements of behalf of CLECs: "Consistent with the Act, FCC Rules and the Eighth Circuit Opinion, we find that

Rule 51.315(b) allows a CLEC to order as combined those elements which an ILEC currently combines." Proposed Order at p. 7. In direct conflict with the Eighth Circuit holding, the Arbitrators found that "the function of a switch and related elements to combine and form a call path is not the type of combination which causes an ILEC to perform a duty to combine elements, but is an intrinsic function and capability of the elements themselves." Proposed Order at p. 7. The "related elements" referred to by the Arbitrators include transport services. On any level, U S WEST will always combine some network elements in provisioning its services. The Proposed Order would require U S WEST to make those combinations available to CLECs at cost based rates. This forced combination completely disregards the Eighth Circuit's Opinion.

The Arbitrators' Proposed Order will require U S WEST to combine within the unbundled switching element sufficient transport to deliver an unspecified number of CLEC calls anywhere within the U S WEST calling area. Under the Proposed Order, AT&T and MCI merely place an order for the prepackaged combined elements making up the 1FR or 1FB , and U S WEST assumes all the business risks to have capacity sufficient to meet the AT&T and MCI demand.

AT&T and MCI do not want U S WEST to combine all the network elements making up a 1FR or 1FB because they cannot obtain such functionality otherwise. AT&T and MCImetro already are free to buy complete 1FRs and 1FBs at discounted wholesale prices under the Commission's resale rules. Rather, they want U S WEST to combine unbundled network elements on their behalf so that they can buy them at the "cost based" price for unbundled network elements— prices that do not contain any contribution toward universal service in Arizona. This will enable AT&T and MCI to obtain the equivalent of resale, but at

the substantially lower unbundled network element prices and without assuming any greater business risk than with resale. Certainly, the appeal of this "lower cost, no risk" scheme to CLECs is self-evident, but it conflicts with the Eighth Circuit's interpretation of U S WEST's obligations under the unbundling provisions of the Act.

The Commission should reject the Arbitrators' use of a left over regulation not even considered by the Eighth Circuit as a means to override the Court's direct and express holding that U S WEST has no obligation to recombine unbundled network elements for CLECs. For the reasons explained below, the Commission should reject the Arbitrators' Proposed Order and modify the interconnection agreements to remove any obligation on the part of U S WEST to recombine unbundled network elements for CLECs.

I. The Arbitrators' Proposed Order Conflicts with the Plain Language of the Eighth Circuit's Opinion.

The Eighth Circuit held that the Act imposes two clear limitations on the provision of unbundled network elements: (1) CLECs are entitled to receive network elements only on an unbundled basis and are responsible for combining them into finished telecommunications services; and (2) when using network elements, CLECs must make an up-front commitment to purchase quantities sufficient to meet their demand forecasts, and bear the business risks of over- or under-ordering. The Arbitrators' finding in the Proposed Order that U S WEST must provide combinations of network elements to AT&T and MCI cannot be reconciled with the Eighth Circuit's holding.

The Court found that section 251(c)(3) of the Act requires only that U S WEST provide CLECs with access to elements of its network "on an unbundled basis" and "in a manner that allows requesting carriers to combine such elements." 47 U.S.C. § 251(c)(3)

(emphasis added). As the Eighth Circuit explained, "the plain meaning of the Act indicates that requesting carriers will combine the unbundled elements themselves" and therefore requesting carriers "will in fact be receiving the elements on an unbundled basis." 1997 WL 403401 at *25 (emphasis added). "We do not believe that [§ 251(c)(3)] can be read to levy a duty on the [ILECs] to do the actual combining of elements." *Id* The Court made it clear that in allowing CLECs to purchase all network elements on an unbundled basis, it was relying on the rationale that its construction of the Act would not allow the purchase of unbundled network elements to become merely an end-run around the resale provisions because purchasers of unbundled network elements would receive only separate pieces of the network and (unlike resellers) would have to bear the additional costs of combining those pieces themselves before they could provide service.

This requirement ensures that CLECs bear the ordinary business risks of being a service provider. The process of combining network elements is the process of designing a network to meet forecasting demand. Contrary to the reasoning in the Proposed Order, this function is not "intrinsic" in any unbundled network element. And, as the Eighth Circuit explained, CLECs providing service through unbundled network elements necessarily must "face greater risks than those carriers that resell an incumbent LEC's services." 1997 WL 403401 at *26. Such CLECs "must make an up-front investment that is large enough to pay for the cost of acquiring access to all of the unbundled elements of an ILEC's network that are necessary to provide local telecommunications services without knowing whether consumer demand will be sufficient to cover such expenditures." *Id.* The Court stressed that its construction of the Act ensured that the ability to purchase all network elements on an unbundled basis would not undercut the resale provisions of the Act because the "decision

requiring the requesting carriers to combine the elements themselves increases the costs and risks associated with unbundled access" as a method of entry. *Id.* In other words, the Court held that, while CLECs can buy all the network pieces necessary to provide a finished service, the burden and cost of combining those pieces into an integrated telephone service falls on the CLECs, and not on U S WEST.

Thus, a CLEC providing service through unbundled network elements must forecast how much traffic it will carry between various network locations, purchase a specific combination of trunks, switches, or other capacity that will be dedicated to carrying the expected traffic, and determine how its customers' calls will be routed over its network. In so doing, the CLEC must balance the risk of purchasing more capacity than it will actually use, against not purchasing enough capacity to handle the traffic generated by its customers, resulting in blocked calls.

But by allowing CLECs to demand that U S WEST provide them with combinations of elements (including combinations that are, in practice no different from finished end-to-end services), the Arbitrators are permitting CLECs to shift their business risks onto U S WEST's shoulders, in violation of the Eighth Circuit's Opinion. If AT&T and MCI can purchase the "1FB combination of elements" as a whole - that is, a local loop, local switching, and undifferentiated network-wide transport - they can avoid having to design a network and make "up-front investments" in particular network capacity and facilities. Instead they will have access to U S WEST's entire network on an as-needed bases. As a result, U S WEST will have to forecast AT&T's and MCI's customer's demand and build capacity to meet that demand. If U S WEST misforecasts the demand of these customers who do not belong to U S WEST and over whom it has no control, or if AT&T and MCI

change their business plans in a way that increases their customers' demand, it is U S WEST's customers who will suffer by experiencing blocked calls. Thus, the Arbitrators' Proposed Order would allow AT&T and MCI to escape the business risks of being a service provider by shifting them onto U S WEST, notwithstanding that the Eighth Circuit said that the Act requires the CLECs to bear these risks as part of the process combining elements.

If, as the Arbitrators found, U S WEST must provide AT&T and MCI with elements already combined in some fashion, then, AT&T and MCI will bear no additional costs or risks associated with combining unbundled network elements. If U S WEST must provide the elements necessary to provide local telephone service already assembled, then there is no "unbundling," and the whole notion that a CLEC is purchasing network elements on an unbundled basis becomes an utter sham. The Arbitrators' ruling thus renders the purchase of combined unbundled elements as simply a method to unfairly arbitrage the different pricing standards contained in the Act for unbundled network elements versus resale of finished retail services.

Finally, if AT&T and MCI are permitted to purchase combinations of network elements that are substantially identical to U S WEST's finished services, they will have no incentive to purchase those services under the Commission's resale rules. The Arbitrators will have destroyed the Eighth Circuit's premises for holding that the unbundling rules did not eviscerate the resale rules. Universal service in Arizona will suffer as a result. The difference between the wholesale price for a finished service and its forward-looking cost is, by definition, a subsidy for residential service in Arizona. If CLECs can buy the practical equivalent of a finished 1FB at cost-based element prices rather than discounted wholesale

prices, they can strip out this above-cost margin and thereby reduce their contributions to universal residential service.

II. FCC Rule 51.315(b) Does Not Support the Finding of the Arbitrators in the Proposed Order.

The Arbitrators relied on FCC Rule 51.315(b) to support the conclusion in the Proposed Order that U S WEST must recombine unbundled network elements for CLECs. That rule, which the Eighth Circuit did not vacate, provides that "except upon request, an incumbent LEC shall not separate requested network elements that the incumbent LEC currently combines." As U S WEST will demonstrate below, the Arbitrators' reliance on Rule 315(b), rather than the express language of the Eighth Circuit's Opinion, was seriously misplaced.[1]

While the Arbitrators noted that the Court did not vacate Rule 315(b), the Proposed Order jumps to the illogical conclusion that the Court must have endorsed this regulation implicitly, and this silent ruling must somehow override the Court's explicit one on element

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[1] The only logical explanation for the Court's decision not to vacate Rule 315(b) is that the Court read the rule as prohibiting an incumbent LEC from breaking down network elements into smaller, sub-element pieces, in light of paragraph 295 of the FCC's First Report and Order in CC Docket No. 96-98. As paragraph 295 makes clear, the FCC defined certain parts of the network as unbundled network elements, but allowed states to define smaller pieces of that element also as unbundled network elements (i.e., breaking the unbundled network element of the local loop into smaller "sub loop" components of feeder, distribution and NID). Thus, in paragraph 295, the FCC mandates that an incumbent LEC must provide "a local loop as a single combined element" -- even though some states require LECs to provide subloop elements -- because the FCC considers "local loops as a single element."

combinations. This makes no sense. The Eighth Circuit may not have mentioned § 51.315(b), but it ruled on the very same subject, holding that incumbents will provide network elements to CLECs "on an unbundled basis." 1997 WL at *26. Whatever § 51.315(b) originally meant, it must now be interpreted consistently with the Eighth Circuit's ruling, and it cannot be read — as the Proposed Order does — in a way that nullifies entire sections of the Court's opinion.[2]

The Arbitrators' reading of Rule 315(b) cannot find support anywhere in the Court's Opinion, and, indeed is flatly inconsistent with the Court's Opinion. The Arbitrators' reading directly contradicts the Court's ruling that "requesting carriers **will in fact** be receiving the elements on an **unbundled basis**," 1997 WL 403401 at *26 (emphasis added), and also guts the Court's critical premise that CLECs must shoulder additional costs to recombine separate, unbundled elements. As a result, the Proposed Order turns the purchase of unbundled network elements into precisely the end-run around the resale provisions of the Act that the Court believed it was avoiding.

Rule 315(b) cannot provide support for the Proposed Order for three reasons. First, the Arbitrators' reading would make Rule 315(b) inconsistent with the plain terms of section 251(c)(3) of the Act, which unambiguously states that an incumbent LEC's duty is to provide

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[2] Simply to clarify that by leaving in this one Rule that the Court did not intend to eviscerate entire sections of its Opinion, on August 19, 1997, GTE, SBC Communications, Bell South and U S WEST filed a Petition for Rehearing with the Eighth Circuit asking the Court to address Rule 315(b) head-on, and either limit its applicability or vacate the Rule.

"access to network elements on an unbundled basis." Requiring U S WEST to provide "those elements which [it] currently combines," Proposed Order at p. 7, does violence to the duty defined by Congress, which was to provide elements "on an unbundled basis."

Second, the Arbitrators' Proposed Order conflicts with the Court's holding that section 251(c)(3) of the Act requires that "**the requesting carriers** will combine the unbundled [network] elements **themselves**," 1997 WL 403401 at *25 (emphasis added), meaning that a CLEC is entitled to receive only disaggregated pieces of the network, not fully integrated telephone services. Requiring U S WEST to provide AT&T and MCI with unbundled network elements already combined into services or parts of services is contrary to the Court's holding that CLECs, and not U S WEST, must "combine the unbundled [network] elements." *Id.*

Finally, the Arbitrators' interpretation of Rule 315(b) would also undermine the Eighth Circuit's rationale for upholding the FCC's rule that CLECs can purchase all of the unbundled network elements necessary to provide a finished telephone service. In upholding those Rules, the Court relied upon its previous ruling that CLECs would receive elements only as unbundled pieces, and on the premise that, because the elements were unbundled, the CLECs purchasing the unbundled network elements (unlike resellers) would face additional business costs and risks to combine them. The Arbitrators' Proposed Order relying on Rule 315(b) undermines both aspects of the Court's reasoning.

The Commission must reject the Arbitrators' reliance on Rule 315(b) because reading that Rule as the Arbitrators have guts the Eighth Circuit's express holding on forced recombination of elements. For the reasons described above, the Commission should

incorporate language into the interconnection agreements tat makes it clear U S WEST has no obligation to recombine unbundled network elements for AT&T or MCI.

III. The "Supplemental Authority" Submitted by AT&T does not Support the Arbitrators' Proposed Order.

On August 19, AT&T submitted the FCC's Third Order on Reconsideration in its local competition docket as "Supplemental Authority" in this arbitration. AT&T notes that in paragraph 44 of this Order, the FCC adopted a reading of Rule 315(b) similar to the one adopted by the Arbitrators here — namely, that the Eighth Circuit's failure to consider the rule somehow constitutes an implicit endorsement of it that overrides entire sections of its Opinion as written. The Commission should recognize that this is a transparent attempt by the FCC to resist the Eighth Circuit's clear mandate, as the statements by FCC Chairman Hundt upon the adoption of the Order make clear. See Separate Statement of Chairman Reed Hundt, Third Report and Order on Reconsideration at 44, FCC 97-295 (rel. August 18, 1997) (describing the Order as "highlight[ing] the importance we place on incumbents making available to new entrants their network elements on a combined basis"). Whatever importance Chairman Hundt places on forcing incumbents to combine network elements for their competitors, he cannot overrule the Eighth Circuit's direct and unmistakable holding that the plain language of the Telecommunications Act forbids this. The Commission may dismiss the FCC's wishful thinking as exactly that.

The Commission should not ignore —as the AT&T, MCI, the Arbitrators, and now Chairman Hundt have done—the Eighth Circuit's core holding that Congress put the job of combining network elements into finished services, as well as the attendant risks of doing business in this fashion, on the CLECs. Rule 315(b), a leftover regulation not specifically

addressed in any of the briefs in the Eighth Circuit and not even mentioned in the Court's Opinion, cannot become the back door for reinstating all of the FCC policies that the Eighth Circuit thought it was overruling. U S WEST notes that the parties petitioning the Eighth Circuit to clarify its mandate with respect to Rule 315(b) have called the Third Report and Order to the Court's attention as well, and they fully expect the Court to strike this down as well. (The letter bringing the Order to the court's attention is attached as Attachment 1.)

Conclusion.

For the foregoing reasons, the Commission should grant the Exceptions of U S WEST to the Arbitrators' Proposed Order, and preclude the interconnection agreements from requiring U S WEST to recombine unbundled network elements on behalf of AT&T and MCI.

DATED: August 25, 1997.

U S WEST COMMUNICATIONS, INC.

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August 20, 1997

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Re: Iowa Utilities Bd., et al. v. FCC.
Nos. 96-3321 and consol. cases.

Dear Mr. Gans:

I write to inform the Court of an important development bearing upon the Petition for Rehearing filed yesterday by the GTE entities, SBC Communications Inc., BellSouth Corporation, and US WEST, Inc. After the petition for rehearing had been transmitted to St. Louis for filing, the Federal Communications Commission released its Third Order on Reconsideration in the local competition docket. See FCC No. 97-295, In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98 (Aug. 18, 1997) (hereinafter "Third Order") (attached).

In that order, the FCC relied on the fact that this Court had not vacated 47 C.F.R. § 51.315(b) in ruling that when incumbent LECs provide requesting carriers both shared transport and local switching as network elements, they may not provide those elements on an unbundled or uncombined basis. Rather, in the FCC's view, if the elements are already combined in the incumbent LEC's own network, the incumbent must provide them to a requesting carrier already packaged together. In the FCC's words, under section 51.315(b) "incumbent LECs may not separate [transport and switching] facilities that are currently combined, absent an affirmative request." Third Order ¶ 44.

The FCC's reliance on section 51.315(b) is directly relevant to petitioners' central argument on rehearing. Petitioners have shown that a similar interpretation of section 51.315(b) advanced by AT&T is wholly insupportable under this Court's decision. In particular, requiring incumbent LECs to provide nominally "unbundled" elements already pre-assembled into a package for providing finished telephone service is flatly inconsistent with the Court's express ruling that requesting carriers "will in fact be receiving [network] elements on an unbundled

basis," slip op. at 143, and also directly undermines the Court's rationale for upholding the ability of requesting carriers to purchase all network elements needed to provide finished service. While the Court relied critically on the additional costs and risks that would accompany a requesting carrier's obligation to recombine elements for itself, allowing carriers to obtain elements already pre-assembled into combinations (at no charge) would eliminate any such costs and risks.

By making clear the FCC's view that section 51.315(b) will require incumbent LECs to provide supposedly "unbundled" elements already pre-assembled into combined packages, the FCC's order substantially increases the pressing need for clarification or reconsideration by this Court. Indeed, the Chairman of the FCC made it clear that the FCC would impose under this rule a duty wholly at odds both with the Court's opinion and with the text of the Act (which requires incumbents to make network elements available "on an unbundled basis," 47 U.S.C. § 251(c)(3)) as he declared that the FCC places particular "importance" on "incumbents making available to new entrants their network elements on a combined basis." Third Order, Separate Statement of Chairman Reed Hundt (emphasis added). Petitioners submit that giving such a scope to the rule cannot be reconciled with the Court's decision or the plain terms of the Act. See generally Pet. for Rehearing at 4-11.

Petitioners respectfully seek leave to file this letter and the attached FCC Third Order in support of their Petition for Rehearing.

Sincerely,

WP Barr (GSC)

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cc: All counsel of record

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